SUHARTA DEVELOPMENT SDN BHD

v.

**UNITED OVERSEAS BANK (M) BHD;
TAHAN INSURANCE MALAYSIA BHD (THIRD PARTY)**

HIGH COURT MALAYA, KUALA LUMPUR
ABDUL WAHAB SAID JC
[CIVIL SUIT NO: D8-22-458-2003]
5 OCTOBER 2004

CONTRACT: *Guarantee - Performance bond - Whether an unconditional on demand guarantee - Whether there was a proper demand - Whether order for summary judgment ought to be affirmed*

CONTRACT: *Guarantee - Indemnification - Defendant issued guarantee in favour of plaintiff - Whether third party had given master indemnity to defendant - Whether judgment for indemnity ought to be entered against third party*

CIVIL PROCEDURE: *Summary judgment - Appeal - Breach of contract - Whether there were triable issues*

The defendant bank had issued a bank guarantee for a sum of RM1,312,400.50 – in favour of the plaintiff as the beneficiary – for the due performance of a contract between one Autoways Construction Sdn Bhd ('Autoways') and the plaintiff. The plaintiff later made a call on the guarantee on the ground that Autoways had committed a breach of its obligation under the contract that the plaintiff had subsequently terminated. The defendant, despite numerous requests, failed to settle the aforesaid sum resulting in the plaintiff filing an application under O. 14 of the Rules of the High Court 1980 against the defendant ('the O. 14 application'). The defendant, however, contended that: (i) the guarantee was conditional; (ii) the plaintiff had failed to comply with the conditions before making the demand; and (iii) Autoways had informed the defendant that it had been relieved from performance of the contract. The defendant filed a statement of claim against the third party for indemnity of the guarantee issued in favour of the plaintiff at the third party's request. The defendant also prayed for this application to be heard and disposed together with the plaintiff's application for summary judgment. The learned senior assistant registrar ('SAR') granted the plaintiff's application and also ordered that judgment be entered against the third party. Hence, the present appeal.

Held:

[1] In determining whether a performance bond or guarantee is conditional or otherwise, the court should not be concerned as to whether there was an actual breach being committed or not; it is for the parties to litigate on that issue. The court is only concerned as to whether, on the wording of the bond, it is an on demand bond. If it is so, the bank has to then pay the person whom it guaranteed. In the instance case, the guarantee was an unconditional on demand guarantee, and the plaintiff had made a proper call or demand on the bank after terminating Autoways for breach of its obligation. Thus, the order of the learned SAR granting the O. 14 application against the defendant was affirmed, with a variation of the order for interest to be from the date the cause of action arose as the plaintiff had been deprived of the use of the money from that date. (pp 462 f & 463 a-b)

[2] The facts were not in dispute that a master indemnity was given by the third party to the defendant. It was clear that in the event the court ordered summary judgment in favour of the plaintiff, the court was also empowered to grant judgment for indemnity by the third party to the defendant. Therefore, the order of the learned SAR that judgment be entered against the third party was affirmed with the condition that execution against the third party should not be issued without the leave of the court until judgment against the defendant had been satisfied. (pp 463 g-h & 464 f)

[Ordered accordingly.]

Case(s) referred to:
Amman Singh v. Vasudevan [1973] 1 MLJ 210 ***(refd)***
LEC Contractors (M) Sdn Bhd v. Castle Inn Sdn Bhd & Anor [2000] 3 CLJ 473 CA ***(foll)***
South East Asia Insurance Bhd v. Nasir Ibrahim [1992] 2 MLJ 355 ***(refd)***
Teknik Cekap Sdn Bhd v. Public Bank Bhd [1995] 4 CLJ 697 CA ***(dist)***

Legislation referred to:
Rules of the High Court 1980, O. 14, O. 16 r. 7(1)

For the plaintiff - P Gananathan (KS Devanathan); M/s Bodipalar Ponnudurai Nathan
For the defendant - Meera Marimuthu; M/s Khaw & Partners
For the 3rd party - Rafizal Ahamadin; M/s Othman Hashim & Co

Reported by Suresh Nathan

JUDGMENT

Abdul Wahab Said JC:

This is an appeal by the third party against my decision affirming the Order of the learned senior assistant registrar granting O. 14 (encl. 7) against the defendant but with the order for interest varied to be from the date the cause of action arose and judgment for the defendant (encl. 23) against the third party.

On 6 November 1997 the defendant bank issued a Bank Guarantee No. 344PG973202 for a sum of RM1,312,400.50 in favour of the plaintiff as beneficiary. The bank guarantee was for the due performance of a contract between Autoways Construction Sdn Bhd and the plaintiff where Autoways contracted to build for the plaintiff 288 units of medium cost apartments in Ampang. Under the guarantee the guarantor agreed that:

> If the Contractor (unless relieved from the performance by any clause of the Contract or by statute or by the decision of a tribunal of competent jurisdiction) shall in any respect fail to execute the Contract or commit any breach of his obligations thereunder, then the Guarantor will indemnify the Principal up to and not exceeding the sum of RINGGIT MALAYSIA ONE MILLION THREE HUNDRED AND TWELVE THOUSAND FOUR HUNDRED AND SEN FIFTY ONLY (RM1,312,400.50) representing 5% of the Contract Sum or such part thereof, on the Principal's demand notwithstanding any contestation or protest by the Contractor or by the Guarantor or by any other Third Party.
>
> Provided always that the total of all partial demands so made shall not exceed the sum of RINGGIT: ONE MILLION THREE HUNDRED AND TWELVE THOUSAND FOUR HUNDRED AND SEN FIFTY ONLY (RM1,312,400.50) and that the Guarantor's liability to indemnify Principal as aforesaid shall correspondingly be reduced proportionate to any partial demand having been made as aforesaid.

By letter dated 23 June 1998, plaintiff made a call on the guarantee on the ground that Autoways Construction Sdn Bhd had committed a breach of its obligation under the contract which plaintiff had terminated.

Autoways Construction Sdn Bhd had filed a writ and a summons in chamber for an interlocutory injunction to restrain the plaintiff from acting and demanding under the bank guarantee. It sought a declaration that the Notice of Termination dated 16 June 1998 by plaintiff's architect was invalid. This suit was however struck out on 9 March 2002. Subsequently on 8 May 2002 Autoways Construction Sdn Bhd was wound up.

Despite numerous requests, the defendant failed to settle the aforesaid sum. Plaintiff thereupon filed this writ. The defendant filed its defence and subsequently a third party notice against Tahan Insurance Malaysia Sdn Bhd. On 25 July 2003, defendant filed the statement of claim against the third party for indemnity. Defendant pleaded that by a letter of offer, defendant agreed to make available to the third party revised credit line amounting to RM9 million for performance guarantees favouring government and private bodies for 36 months. By a master indemnity for bank guarantee dated 22 January 1997 the third party agreed to indemnify defendant for guarantee issued at third party's request. On 31 October 1992 on the application by third party the defendant issued a guarantee in favour of the plaintiff for due performance by Autoways Construction Sdn Bhd in the aforesaid contract to build the medium cost apartment.

The plaintiff filed for summary judgment on 7 May 2003. The defendant raised the following issues:

1) the guarantee is conditional;

2) the plaintiff failed to comply with the conditions before making the demand;

3) the contractor Autoways Construction Sdn Bhd had informed the defendant *vide* letter dated 23 June 1998 that they (Autoways) had been relieved from performance of the contract.

A performance bond or guarantee is in fact a written contract to guarantee due performance in the event of breach or non performance of the contract. In determining whether it is conditional or otherwise, the court is concerned with the contractual construction or interpretation of the bond or guarantee itself. A great deal depends on the wording of the guarantee itself to discover the intention of the parties.

The defendant contended that the terms of the guarantee is conditional and cited *Teknik Cekap Sdn Bhd v. Public Bank Bhd* [1995] 4 CLJ 697 whilst the plaintiff relied on *LEC Contractors (M) Sdn Bhd (formerly known as Lotterworld Engineering & Construction Sdn Bhd) v. Castle Inn Sdn Bhd & Anor* [2000] 3 CLJ 473. In both the cases the terms of the bond are similar to that in the case before me. The Court of Appeal in *Teknik Cekap Sdn Bhd* held the bond to be conditional but in *LEC Contractors (M) Sdn Bhd* held it is an on demand bond.

In *LEC Contractors (M) Sdn Bhd* Mokhtar Sidin JCA distinguished the case of *Teknik Cekap* and at p. 496 said:

> That is the position of an on demand performance bond. It is clear to us that the bank guarantee in the present appeal is a performance bond. From the wordings of the guarantee it is clear to us that it is 'on demand' performance bond as stated in *Esso Petroleum Malaysia Inc v. Kago Petroleum Sdn Bhd*: 'All that was required to trigger them was a demand in writing'; or in the words of Mohamed Dzaiddin FCJ in the case of *China Airlines Ltd v. Maltran AirCorp Sdn Bhd*: '... the guarantor will become liable merely when demand is made upon by the beneficiary with no necessity for the beneficiary to prove any default by the principal in performance of the principal contract.
>
> The appellant claimed that the bank guarantee is a conditional bond. To support this contention learned counsel for the appellant referred to the case of *Teknik Cekap*, a decision of this court where the court held that a performance bond was a conditional bond. It was held by the court that because the bond began with the words 'if the sub-contractor ... shall in any respect fail to execute the contract or commit any breach of his obligations thereunder then the guarantor shall pay ...'. Apparently this is the only case in Malaysia where similar wordings had been used where the court had held that it was a conditional bond. In our view the court in the case of *Teknik Cekap* decided it on its own facts. Apparently one of the factors that influenced the court and the court below was the fact that the demand made was bad in law. This in our view distinguished that case from the present appeal.
>
> From the authorities we have referred earlier it is clear to us that to determine whether a performance bond is a conditional or unconditional bond, the court should not be concerned whether there was actual breach being committed or not. It is for the parties to litigate as to whom the blame is to be placed. The court is only concerned whether on the wordings of the bond, it is an on demand bond. If it is so then the bank has to pay the person whom it guaranteed. The only exception to this is in the case of fraud which comes to the notice of the bank. As we have said earlier it is clear to us that this is an on demand performance bond. A proper demand had been made and as such the bank (second defendant) is obliged to pay the first defendant the amount stated in the bond. As to whether the plaintiff or the first defendant was at fault is not the concern of the bank. That dispute is for the parties to the contract to settle either by arbitration or by litigation in court. The bank has no choice but to pay the amount demanded. The first defendant is entitled to that sum not under the contract but under the performance bond.

I followed *LEC Contractors (M) Sdn Bhd* and hold this guarantee is an unconditional on demand guarantee.

I am satisfied that a proper call had been made on 23 June 1998 by plaintiff on the bank after terminating the contractors on 16 June 1998 for breach of its obligation under the contract. A copy of the termination letter was also appended to the letter making the call.

For the aforesaid reasons, I thereby affirmed the order of the learned SAR granting O. 14 against the defendant. I however allowed the plaintiff's appeal and ordered interest instead from the date the cause of action arose as the plaintiff had been deprived of the use of the money from that date.

The defendant by encl. 23 prayed for the following orders against the third party:

1) that the application in encl. 23 be heard and disposed off together with the plaintiff's application for summary judgment against the defendant *vide* summons in chambers dated 7 May 2003 ("summary judgment proceedings");

2) that the third party do indemnify the defendant against the claim of the plaintiff for any judgment awarded by the court together with all costs incurred by the defendant in defending this action and the costs of these third party proceedings against the third party;

3) that the defendant be at liberty to enter judgment against the third party for all sums of monies, if any, awarded to the plaintiff against the defendant in the summary judgment proceedings;

4) that the third party do pay the defendant the costs incurred (on a solicitor client basis) in defending the action by the plaintiff and of the third party proceedings.

The learned SAR heard this encl. 23 together with encl. (7). The facts are not in dispute that a master indemnity was given by third party to defendant. It is clear that in the event the court orders summary judgment in favour of the plaintiff, the court is also empowered to grant judgment for indemnity by the third party to the defendant. The factual matrix of the case is so closely linked that the hearing and disposal of encl. 23 simultaneously with the plaintiff's summary judgment proceedings would save the court's time and enable the court to fully and completely adjudicate on the disputes between all the parties to the proceedings.

The defendant submitted that contrary to the assertion of the third party, the defendant's application *vide* encl. 23 is not premature and the court is duly empowered to grant orders-in-terms pursuant to O. 16 r. 7(1) of the Rules of the High Court 1980 ("RHC") which states:

> Where in any action, a defendant has served a third party notice, the court may at or after the trial of the action, or *if the action is decided otherwise, than by trial, on an application by summons or motion, order such judgment as the nature of the case may required to be entered for the defendant against the third party.*

The Supreme Court in *South East Asia Insurance Bhd v. Nasir Ibrahim* [1992] 2 MLJ 355 held:

> A contract of indemnity is defined in s. 77 of our Contracts Act 1950 as 'a contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person'. In a contract of indemnity, the promisor undertakes an original and independent obligation to indemnify, as distinct from a contract of guarantee which is a collateral contract by which the promisor undertakes to answer for the default of another person who is to be primarily liable to the promise.

In *Amman Singh v. Vasudevan* [1973] 1 MLJ 210 the High Court held:

> Section 77 of the Contracts (Malay States) Ordinance defines what a contract of indemnity is, and section 78 provides the rights of the indemnity holder when he is sued, against the promisor.

The defendant is entitled to be indemnified by the third party against any judgment granted by the court in the plaintiff's summary judgment application. For these reasons I affirmed the order of the learned SAR that judgment be entered against the third party except that execution against the third party shall not be issued without the leave of the court until the judgment against the defendant has been satisfied.